

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF SOUTH DAKOTA

IN THE MATTER OF THE APPLICATION OF)	FINDINGS OF FACT AND
NORTHWESTERN PUBLIC SERVICE FOR)	CONCLUSIONS OF LAW;
AUTHORITY TO INCREASE RATES FOR)	NOTICE OF ENTRY OF
NATURAL GAS SERVICE)	ORDER
)	NG99-002

On June 1, 1999, NorthWestern Public Service, a division of NorthWestern Corporation (NWPS), filed with the Public Utilities Commission (Commission) an application to increase natural gas rates in South Dakota. The application sought an overall increase in rates in the amount of \$2,108,112 or approximately 6%. The Company requested a change in rates to become effective for billings after July 1, 1999.

At its regularly scheduled meeting of June 22, 1999, the Commission found that pursuant to SDCL 49-1A-8, NWPS shall be assessed a filing fee as requested by the executive director up to the statutory limit of \$100,000. The Commission further established an intervention deadline of July 22, 1999. Pursuant to SDCL 49-34A-14, the Commission suspended the operation of the schedule of rates proposed by NWPS for 90 days beyond July 1, 1999. By Order dated September 14, 1999, the Commission further extended the suspension through December 1, 1999.

The Commission scheduled the matter for hearing on October 20-21, 1999, starting at 9:00 A.M. CDT, on October 20, 1999, in Room 413, State Capitol, Pierre, South Dakota. On October 18, 1999, Commission Staff notified the Commission that NWPS and Commission Staff had reached a settlement agreement which increased the rates in the amount of \$1,279,025. Staff requested that the Commission consider the settlement agreement on October 20, 1999. An issue related to NWPS' purchased gas adjustment (PGA) was separated from the rate case issues and was heard at the October 20, 1999, hearing. The issue was whether NWPS was entitled to recover certain costs it had placed in its PGA. On November 1, 1999, at a regularly scheduled meeting, the Commission approved the settlement agreement with an effective date of December 1, 1999. The PGA issue was briefed by NWPS and Commission Staff.

At its April 13, 2000, meeting, the Commission considered the remaining PGA issue. The Commission found that the portion of the \$588,000 for capacity costs from Northern Natural which NWPS has placed in its PGA is not a recoverable cost under the fuel clause and ordered NWPS to remove that amount from its PGA. The Commission further found that the allowed pipeline cost of service shall be the following costs listed on Exhibit 3: the pre-tax return, property taxes, and administrative costs of the Aberdeen pipeline. The Commission further found that Staff's request for an NWPS refund with interest must be denied as not allowed under SDCL 49-34A-25. (Commissioner Schoenfelder dissented.)

Based on the evidence of record, the Commission makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. NWPS is a local distribution company. Tr. at 23. It is a division of NorthWestern Corporation and is a utility whose rates are regulated by the Commission. Tr. at 13, 55.

2. NorthWestern Energy Corporation (NEC) is a subsidiary of NorthWestern Corporation. Tr. at 55. NEC is a non-regulated marketing arm of NWPS. Tr. at 8. As a non-regulated marketing entity, NEC is able to acquire natural gas supplies and capacity on interstate pipelines and then bundle those services to provide individual customers with gas service. Tr. at 13.
3. Nekota is a direct subsidiary of NEC. Tr. at 55. Nekota was created to hold the physical assets of a pipeline that bypassed the Northern Natural Gas (NNG) pipeline by connecting to the Northern Border pipeline (NBPL). Tr. at 21, 30-31. The bypass pipeline (hereafter referred to as the Aberdeen Pipeline) runs from Aberdeen to the NBPL. Tr. at 21, 66.
4. As a regulated utility, NWPS tracks the costs of acquiring capacity and procuring natural gas and these costs are billed to customers through the purchased gas adjustment (PGA). Tr. at 12. Each month the costs that are actually incurred are compared to the costs recovered through rates and any differential is trued up and reserved for a future recovery or refund back to the customer. Tr. at 12-13.
5. In February of 1996, NWPS was experiencing a shortage of firm capacity necessary to meet firm requirements. Tr. at 16-17. In order to alleviate this shortage, NWPS considered bypassing NNG by building a pipeline to Aberdeen from the NBPL. Tr. at 21. NNG operates a large capacity interstate pipeline which provided 49,000 MMBtus to NWPS. Tr. at 23. NWPS also wanted to negotiate other provisions with NNG, notably realigning its delivery point capacities and turning back field firm capacity for market firm capacity. Tr. at 27-29. Field firm capacity refers to production area capacity. Tr. at 28. Local distribution companies which contracted for firm market pipeline capacity from NNG were obligated to take field firm capacity. Tr. at 27-28. Field firm capacity was of no value to NWPS due to the location of the capacity. Tr. at 28-29.
6. On December 21, 1990, NWPS entered into a letter agreement with NNG which stated that NWPS agreed to maintain existing firm entitlement levels for a minimum of ten years and use NNG's system for all throughput for ten years for communities currently served by NNG (hereafter referred to as exclusivity provision). Tr. at 26; Exhibit 2.
7. NWPS stated that NNG agreed to waive this exclusivity provision if NEC bought enough services from NNG. Tr. at 31. NNG also agreed to allow NWPS to realign its delivery point capacities and turn back field firm for market firm. Tr. at 31-32; Exhibit 8.
8. The bypass pipeline was completed in late October of 1996. Tr. at 66. The pipeline cost \$1,185,000.00. Tr. at 82.
9. Effective November 1, 1996, NWPS and NEC entered into an agreement allowing NWPS to purchase capacity from NEC on the Aberdeen pipeline. Tr. at 136; Late-filed Exhibit, Aberdeen City-Gate Transportation Services Agreement. NWPS pays all of the Aberdeen pipeline's inspection costs and operation and maintenance expenses for the first five years. Tr. at 137.
10. On February 14, 1997, NEC entered into a contract with NNG to buy 5000 MMBtus plus deferred delivery service. Tr. at 96; Late-filed Exhibit, Letter Agreement between NEC and NNG. The capacity is used by NEC for its agency business. Tr. at 79. The contract was for five years. Tr. at 95.
11. On February 14, 1997, NWPS entered into a letter agreement with NNG. Exhibit 8. The agreement contained provisions which waived the exclusivity provision, changed delivery point capacity, and allowed the purchase of market firm to replace field firm. Tr. at 38-39; Exhibit 8.

12. In its November 1, 1996, PGA filing with an effective date of December 1, 1996, NWPS placed \$576,000.00 into the PGA and identified the amount as "NBPL-Aberdeen capacity." Tr. at 134, 136, 139, 146; Exhibit 5. This amount actually contained costs associated with the Aberdeen pipeline owned by Nekota and costs paid by NEC to NNG for capacity. Exhibit 3. Commission Staff was unaware that NWPS was flowing costs of an affiliate pipeline through the PGA. Tr. at 145. NWPS conceded that the identification of the Aberdeen pipeline as "NBPL-Aberdeen capacity" would give no indication that it was actually an affiliate transaction. Tr. at 68.

13. NWPS claimed the following project benefits from the building of the Aberdeen pipeline: (1) removal of NNG exclusivity provision; (2) increase in peak day pipeline capacity; (3) increased reliability; (4) the turnback of field firm capacity and conversion to market firm capacity; (5) increased capacity credits; and (6) ability to maintain interruptible customers on peak days. Exhibit 3; Tr. at 37-41.

14. NWPS claimed the following costs of \$824,000.00 associated with the Aberdeen pipeline: (1) \$588,000.00 -- capacity costs paid to NNG for firm transportation and deferred delivery service; (2) \$165,000.00 -- pre-tax return on Aberdeen pipeline; (3) \$23,000.00 -- property taxes on Aberdeen pipeline; (4) \$48,000.00 -- administrative costs for regulatory review, balancing, nominations, and procurement on NBPL. Exhibit 3. NWPS then assigned 70% of the costs to NWPS and 30% to NEC. *Id.* This assignment was based on a total assigned firm capacity of 21,500 MMBtus with 15,000 assigned to NWPS and 6,500 to NEC. *Id.* NWPS then flowed 70% of the \$824,000.00 through the PGA. Exhibit 5.

15. NWPS stated that in order to buy an additional 15,000 MMBtus from NNG it would have cost \$1,197,000.00 annually. Tr. at 36-37.

16. NWPS stated that the letter agreement between NNG and NEC for the purchase of 5000 MMBtus plus deferred delivery represented, in part, a buy-out of the exclusivity provision contained in the 1990 letter agreement between NWPS and NNG. Tr. at 73-74. However, NWPS was unable to identify any portion of the \$588,000.00 that could be attributed to the claimed buy-out. Tr. at 101.

17. Under the letter agreement between NEC and NNG, NEC buys 5,000 MMBtus of firm pipeline capacity at a base rate, plus surcharges, and buys deferred delivery service at NNG's maximum rate. Tr. at 96. The base rate was \$3.00 for the summer months and \$3.50 for the winter months. Tr. at 97-98. The amount of \$588,000.00 was based on actual costs incurred during 1998. Tr. at 98. The total amount paid will vary from year to year. Tr. at 96-97.

18. The 5000 MMBtus is capacity needed by NEC and is not excess capacity. Tr. at 100. When NEC sells that capacity, it keeps the revenues associated with those sales. Tr. at 80. Thus, the revenues are not used to offset the amount allocated to NWPS even though NWPS is allocated 70% of the costs of that capacity. *Id.* NEC sells that capacity to its agency customers. Tr. at 79.

19. NWPS stated that it intended to allocate 70% of the \$588,000.00 to NWPS for ten years. Tr. at 102. When asked why NWPS would be charged 70% of the \$588,000.00 for ten years when the agreement between NEC and NNG was for five years, the response was that NEC will need capacity beyond five years and, after the five year agreement expired, the cost would probably be higher. Tr. at 102.

20. Commission Staff stated that the charges passed through the PGA should "be reduced to a level that reflects Nekota's cost of providing the capacity." Tr. at 134; Exhibit A. Commission Staff further stated that this adjustment be made effective retroactive to December 1996 and that the amount

disallowed be flowed back to the ratepayers, with interest, over a three year period through the PGA. Tr. at 134, 139.

21. The Commission finds that NWPS has failed to prove that 70% of the \$588,000 allocated to it is a recoverable PGA cost. The \$588,000.00 is a cost incurred by NEC for capacity that it needs and uses. Tr. at 79-80. Although NWPS maintained the \$588,000.00 represented, in part, a buy-out of the exclusivity provision contained in the 1990 NWPS/NNG agreement, NWPS failed to show that the rates NEC pays to NNG are higher than normal rates. There was no showing that the agreement included additional costs associated with a buy-out of the exclusivity provision. NEC needs that capacity for itself, sells it to its agency customers, and keeps the revenues from those sales. Tr. at 79-80. Moreover, NWPS stated that a new contract for NEC capacity would probably be higher in five years. Tr. at 102.

22. NWPS' argument that purchasing additional capacity from NNG would have cost more than \$576,000.00 ignores the essential problem presented in this case: a company may not pass through its PGA costs incurred by an affiliate for capacity used by the affiliate.

23. In addition, the Commission finds it very disturbing that NWPS would continue to be allocated 70% of the \$588,000.00 for ten years when the agreement between NEC and NNG was for five years. If the \$588,000.00 had indeed represented, in part, a buy-out of the exclusivity provision, why would NWPS continue to pay for that buy-out for an additional five years beyond what NNG allegedly required for the buy-out? Moreover, at the time the five year agreement between NEC and NWPS was entered into, the 1990 agreement that contained the exclusivity provision was set to expire in less than four years. Exhibit 2. NWPS' rationale for the additional five years was that NEC would need capacity beyond the first five years and rates would probably be higher. Tr. at 102. Of course this begs the question as to why, higher costs or not, NWPS should be responsible for paying for any of NEC's capacity needs.

24. The Commission finds that it will allow NWPS to flow through the PGA the costs associated with the Aberdeen pipeline. NWPS stated that it was entitled to all of the capacity on the pipeline. Tr. at 43, 57, 93. In addition, NWPS is paying for all of the Aberdeen pipeline's inspection costs and operation and maintenance expenses for the first five years. Tr. at 137. The Commission finds that the costs of \$165,000 for pre-tax return, \$23,000.00 for property taxes, and \$48,000.00 for administrative costs are reasonable and shall be allowed. The Commission further finds that since these costs represent the entire pipeline, NWPS may not flow through the PGA any additional amounts it may pay NEC for capacity above 15,000 MMBtus. Further, if any entity other than NWPS uses capacity on the Aberdeen pipeline, then NWPS' responsibility for the costs of the pipeline shall be reduced in proportionate amount to the capacity used by the other entity.

25. The Commission denies Commission Staff's request that NWPS be required to refund with interest any previous amounts collected pursuant to the allocation of 70% of the \$588,000.00. The Commission finds that a refund is not allowed under SDCL 49-34A-25.

CONCLUSIONS OF LAW

1. The Commission has jurisdiction over this matter pursuant to SDCL Chapters 1-26 and 49-34A, including 1-26-18, 1-26-19, 49-34A-2, 49-34A-3, 49-34A-4, 49-34A-6, 49-34A-8, 49-34A-10, 49-34A-11, 49-34A-12, 49-34A-13, 49-34A-13.1, 49-34A-14, 49-34A-16, 49-34A-17, 49-34A-19, 49-34A-19.1, 49-34A-19.2, 49-34A-20, 49-34A-21, 49-34A-22, 49-34A-23, 49-34A-25, and 49-34A-26.

2. SDCL 49-34A-25 provides as follows:

The commission shall permit a public utility to file rate schedules containing provisions for the automatic adjustment of charges for public utility service in direct relation to changes in wholesale rates for energy delivered, the delivered costs of fuel used in generation of electricity, the delivered cost of gas, ad valorem taxes paid, or commission approved fuel incentives. The amended rate schedules shall be filed with the commission on or before the effective date of the change in costs, and if the commission determines that the revised rate schedule is in error, the commission may within ten days of receipt thereof require by order the public utility to file a bond or other security upon such terms and conditions as the commission may require and for such purposes as contained in §§ 49-34A-17 and 49-34A-22. Such rates may go into effect on the date of the change in costs subject to the above refund provisions. Failure of the commission to enter an order in regard thereto shall be deemed approval. The public utility may appeal such order pursuant to and in accordance with § 49-34A-62.

3. The Commission finds that the allocation of 70% of \$588,000.00 to NWPS' fuel clause is unreasonable and not allowed under SDCL 49-34A-25. NWPS has failed to prove that 70% of the \$588,000 allocated to it is a recoverable PGA cost. See Finding of Fact 21.

4. The Commission finds that it will allow NWPS to flow through the PGA the costs associated with the Aberdeen pipeline. NWPS stated that it was entitled to all of the capacity on the pipeline. Tr. at 43, 57, 93. The Commission finds that the costs of \$165,000 for pre-tax return, \$23,000.00 for property taxes, and \$48,000.00 for administrative costs are reasonable and shall be allowed. The Commission further finds that since these costs represent the entire pipeline, NWPS may not flow through the PGA any additional amounts it may pay NEC for capacity above 15,000 MMBtus. Further, if any entity other than NWPS uses capacity on the Aberdeen pipeline, then NWPS' responsibility for the costs of the pipeline shall be reduced in proportionate amount to the capacity used by the other entity.

5. The Commission finds it is unable to order NWPS to refund with interest any previous amounts collected pursuant to the allocation of 70% of the \$588,000.00. The Commission finds that a refund is not allowed under SDCL 49-34A-25 based on the language that states that "[f]ailure of the commission to enter an order in regard thereto shall be deemed approval."

It is therefore

ORDERED, that NWPS shall remove from its PGA the portion of the \$588,000 for capacity costs from NNG which NWPS has placed in its PGA.

NOTICE OF ENTRY OF ORDER

PLEASE TAKE NOTICE that this Order was duly entered on the 27th day of April, 2000. Pursuant to SDCL 1-26-32, this Order will take effect 10 days after the date of receipt or failure to accept delivery of the decision by the parties.

Dated at Pierre, South Dakota, this 27th day of April, 2000.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that this document has been served today upon all parties of record in this docket, as listed on the docket service list, by facsimile or by first class mail, in properly addressed envelopes, with charges prepaid thereon.

By: _____

Date: _____

(OFFICIAL SEAL)

BY ORDER OF THE COMMISSION:

JAMES A. BURG, Chairman

PAM NELSON, Commissioner

LASKA SCHOENFELDER, Commissioner,
dissenting

Dissent of Commissioner Schoenfelder

Even though we deal with complex issues and dockets on a daily basis, this docket was more difficult than most. NorthWestern Public Service (NWPS), which is regulated, joined with unregulated affiliates Northwestern Energy Corporation (NEC) and Nekota Resources, Incorporated (Nekota) to increase pipeline capacity. The increased capacity came from Northern Natural Gas (NNG), and from Northern Border Pipeline Company via the Nekota Pipeline. NEC negotiated with NNG on NWPS contractual matters, while Nekota, a subsidiary of NEC, built a pipeline which provided capacity for NWPS. All of this took place over three years ago. This already complex matter was further complicated when the record was limited to testimony brought to the table on the day of hearing and several late-filed exhibits.

The majority made their decision in spite of an undeveloped record that left too many questions unanswered. The majority decision may even be one with which I could agree if there were enough facts to support it. Conversely, NWPS took steps in 1996 to alleviate a system capacity shortage and eliminate an onerous NNG contractual clause. NWPS believes this was done in a creative and cost-effective manner. The majority's decision could effectively penalize NWPS for lowering customer gas costs. Again, the record does not offer enough support for this conclusion.

I am deeply disturbed that it is now necessary to address this issue. The Nekota Pipeline was built over three years ago. The NNG contract was changed over three years ago. The costs have since been included in the purchased gas adjustment (PGA) clause, unnoticed by staff. Staff should have certainly noticed this major new PGA cost item long before the rate case was filed.

NWPS may not be obligated to inform staff when this type of change occurs, but maybe they should. NWPS made it clear at the hearing that the project was an extremely significant capacity addition. Does NWPS believe major transactions should not receive scrutiny at the outset? If it was such a good deal NWPS should be willing to support it before ratepayers are asked to pay. NWPS and staff need to address their individual actions, and maybe the first step for both is by improvement in communication.